RECENT CASES

Civil Rights—

DISCRIMINATORY CONDITION IN GRANT TO CITY RECREATION COMMISSION FOR PUBLIC PARK UPHELD

In 1929 the City of Charlotte and Barringer, a private citizen, conveyed land to a public corporation in charge of city recreation facilities to be used for a municipal park.[1] Both deeds provided that if the park should not be used exclusively by whites, the land would revert to the grantors. In 1951 a group of Negroes petitioned the Commission for access to the park in order to use the city's only municipal golf course, whereupon the Commission sought a declaratory judgment as to the legal consequences of allowing Negroes to use the course. The court held that the Barringer grant had created a valid fee simple determinable which would revert to the grantor automatically if Negroes were permitted to use the golf course, but that the grant from the city would not revert if the condition were breached since it was void as a violation of the fourteenth amendment. *Charlotte Park & Recreation Commission v. Barringer,* 88 S.E.2d 114 (N.C. 1955).

A condition on an estate is void if the acts required to perform it are contrary to law or public policy or are otherwise impossible to discharge;[2] and, if the condition is void, the estate is free of the condition.[3] Thus, where a grantor sold land to a railroad on the condition that the railroad not build a station within three miles of a certain city, the court held the condition void because the restriction was contrary to the best interests of the public and the stockholders;[4] and, where a grantor gave land to a college on condition that the land revert if the receipts therefrom were not used for a perpetual fund, the condition was held void when it conflicted with the charter of the college.[5] Therefore, if the conduct required to carry out the condition in the instant case—the Commission's excluding Negroes from the golf course—is unlawful, the court should have declared the condition void. The recent Supreme Court rulings in *Mayor of Baltimore v. Dawson*[6] and *Holmes v. City of Atlanta*[7] make it clear that a municipality

1. Two other grantors were parties in the action but the disposition of their claims is not relevant to this Comment.

2. Keyser v. Calvary Brethern Church, 192 Md. 520, 64 A.2d 748 (1949); Fidelity Insurance, Trust & Safe-Deposit Co. v. Fridenberg, 175 Pa. 500, 34 Atl. 848 (1896). See 1 TIFFANY, REAL PROPERTY § 199 (3d ed. 1939).

3. See note 2 *supra;* 6 AMERICAN LAW OF PROPERTY § 26.83 (Casner ed. 1952).

4. Jacksonville & Chicago R.R. v. Mathers, 71 Ill. 592 (1874).

5. Trustees of Eureka College v. Bondurant, 289 Ill. 289, 124 N.E. 652 (1919).

6. 24 U.S.L. WEEK 3128 (U.S. Nov. 7, 1955), *affirming,* 220 F.2d 386 (4th Cir. 1955).

7. 24 U.S.L. WEEK 3128 (U.S. Nov. 7, 1955), *reversing,* 223 F.2d 93 (5th Cir. 1955), *affirming,* 124 F. Supp. 290 (N.D. Ga. 1954).

may not lawfully exclude Negroes from a public recreation facility, and, in the light of these decisions the condition necessarily would have been void. However, the Supreme Court had not stated its position when the instant case was decided. At that time there was some authority for applying the "separate but equal" doctrine to recreational facilities,[8] but even under this doctrine Negroes would be entitled to use municipal recreational facilities if there were not "separate but equal" facilities available for them.[9] Since the City of Charlotte did not, in fact, have another municipal golf course,[10] the Commission could not lawfully exclude Negroes, and, therefore, the court should have invalidated the condition.

In the instant case, the court ruled that, since the condition established a determinable fee,[11] if it were breached, title would revert automatically to the grantor.[12] In reaching this conclusion, the court stated[13] that, since the reversion took place "automatically," there was no state action in its determination, within the meaning of the fourteenth amendment, and hence no conflict with *Shelley v. Kraemer*.[14] There, the Supreme Court invalidated the use of state judicial power which gave effect to a discriminatory agreement by enjoining a Negro from taking possession of land and by divesting him of title to the land because the sale to him violated a restrictive covenant.[15] The instant case may be highly significant because

8. Holmes v. City of Atlanta, 124 F. Supp. 290 (N.D. Ga. 1954), *aff'd*, 223 F.2d 93 (5th Cir. 1955), *rev'd*, 24 U.S.L. WEEK 3128 (U.S. Nov. 7, 1955); see Kansas City v. Williams, 205 F.2d 47 (8th Cir. 1953), *cert. denied*, 346 U.S. 900 (1954); Beal v. Holcombe, 193 F.2d 384 (5th Cir. 1951), *cert. denied*, 347 U.S. 974 (1954); Hayes v. Crutcher, 108 F. Supp. 582 (M.D. Tenn. 1952); Note, 34 NEB. L. REV. 553 (1955); 7 ALA. L. REV. 153 (1954).

9. See note 8 *supra*.

10. Instant case at 118.

11. For the characteristics of the determinable fee, see First Universalist Society v. Boland, 155 Mass. 171, 29 N.E. 524 (1892); Hall v. Turner, 110 N.C. 292, 14 S.E. 791 (1892); 1 RESTATEMENT, PROPERTY §§ 23, 44 (1936) and comments thereto; 1 AMERICAN LAW OF PROPERTY §§ 2.6, 4.12 (Casner ed. 1952).

12. Instant case at 123. Although the court upheld the condition in the grant from Barringer, it invalidated it in the grant from the City of Charlotte. The court gave no explanation for distinguishing between the public and private grantors and there does not seem to be one, for the acts required by the Commission to carry out the condition are unlawful in themselves and do not derive their illegality from the nature of the grantor. It is possible that in certain situations the character of the grantor could make a difference. For example, if a private grantor and the state each granted land to a private school with the condition that the school exclude Negroes, the condition in the private grant would probably be valid but that in the public grant void on the theory that the state's establishing such a restriction would be contrary to the fourteenth amendment even though the performance itself might be legal.

13. Instant case at 123.

14. 334 U.S. 1 (1947).

15. The Court expanded this doctrine in Barrows v. Jackson, 346 U.S. 249 (1953), when it denied damages for breach of a racially restrictive covenant. But in Rice v. Sioux City Memorial Park Cemetery, Inc., 245 Iowa 147, 60 N.W.2d 110 (1953), *aff'd by an equally divided Court*, 348 U.S. 880 (1954), *judgment vacated on rehearing*, 349 U.S. 70 (1955) the Court refused to extend *Shelley* to give the victim of a discriminatory practice a cause of action for damages against a party who had agreed to and abided by a discriminatory condition.

it could open the way to the use of the determinable fee to replace the restrictive covenant, rendered virtually useless by *Shelley,* for excluding Negroes from land.[16] Subsequent litigation arising from the declaratory judgment could originate in two situations: first, the reversioner might seek court aid to obtain possession of his land; second, the reversioner, having managed to gain possession by his own devices, might invoke his "title" as a defense to a suit by the grantee, or his successor in interest, to eject him.[17] The first type of suit closely resembles *Shelley,* both in the position of the parties and the character of the remedy requested. A distinction might be attempted, however, on the theory that the court in so acting is not enforcing the discriminatory condition, but merely removing a person whose right to possession had terminated "automatically" when the condition was breached. Such conceptualistic reasoning, however, cannot hide the fact that the practical result of a court's granting such relief would be to effectuate the discriminatory condition by exercise of state power. The second type of case, in which a reversioner in possession sets up his "title" as a defense, admittedly is more difficult. It will arise where the grantor regains possession, either by a forceful entry[18] or by moving on the land after a voluntary abandonment.[19] If a court recognizes "title" in the grantor, it may feel compelled not to eject him in favor of one who admittedly has no "title." Once again, however, this conceptualistic reasoning masks the true import of such a decision. It would be to effectuate the discriminatory condition by allowing its breach to be used as a valid defense in an action brought to eject the grantor. Thus, analyzed the case appears contra to *Clifton v. Puente,*[20] in which the Texas Court of Civil Appeals, on the authority of *Shelley v. Kraemer,* struck down such a defense on the theory that it is as much state action to "deny to a person a legal right to which he would be entitled except for the covenant as it would be to expressly command by judicial order that the terms of the covenant be recognized and carried out."[21] Restated to cover the hypothetical case the rule would read: it is unconstitutional for a state court to give effect to a discriminatory condition either by granting to or leaving with the reversioner rights based upon that discriminatory condition. If this rule were

16. See Note, 4 Ky. L.J. 151, 160-62 (1954), in which various devices that may be used to avoid *Shelley* are considered.

17. Clifton v. Puente, 218 S.W.2d 272 (Tex. Civ. App. 1948) presents an analogous situation. See text at note 20 *infra.*

18. *Ibid.*

19. It is likely in the instant case that the Commission would be in sympathy with the grantor's wish to maintain segregated facilities; thus it is quite possible that the Commission would voluntarily abandon the land in favor of the grantor. The condition precedent of a payment of $3500 to the Commission could be easily satisfied. Instant case at 118.

Although highly speculative, it is at least arguable that the act of abandoning the park to the grantor might be state action contrary to the fourteenth amendment inasmuch as by so doing the Commission would be contributing to the success of the discriminatory practice.

20. 218 S.W.2d 272 (Tex. Civ. App. 1948).

21. *Id.* at 274.

used in the two cases posed to deny a remedy to the reversioner, the declaratory judgment in the instant case would be as devoid of legal consequence as the statement in *Shelley* that the restrictive covenant there was valid but unenforceable.[22]

Corporations—

DIRECTOR'S LIABILITY BROADENED TO INCLUDE USURPATION OF OPPORTUNITY MERELY ADVANTAGEOUS TO INVESTMENT TRUST

Defendant, a wealthy investor, who was president and director of an investment trust, was offered personally and orally accepted certain patents and all the stock of the exclusive licensee of those patents. He relayed this offer to his investment trust, which was highly liquid and actively seeking investment opportunities. He counseled purchase of the licensee alone, advising that rejection of the patents would allow the trust to diversify its holdings, and also that the patents might not prove as profitable as they appeared.[1] In the course of an informal meeting of the board of directors at defendant's home, the two other board members present voted to purchase the licensee and to reject the offer of the patents; defendant did not vote, nor was his presence necessary for a quorum.[2] Thereupon in simultaneous transactions the patents were purchased by defendant and the licensee by the trust; defendant then transferred the patents at cost to others pursuant to a prearranged plan.[3] A stockholder of the trust brought a derivative suit asking for an accounting. The court found that defendant, in purchasing the patents, had wrongfully appropriated a corporate opportunity belonging to the trust, and that the rejection by the board in the vote of the two directors did not make out a good faith defense because the board was dominated. The finding of domination was based primarily on the fact that, of those directors at the meeting, one recently had been employed by a corporation controlled by defendant and the other was a

22. 334 U.S. at 13.

1. He pointed out that 75% of the licensee's business was composed of government contracts the profits from which were subject to renegotiation. Transcript p. 24, cited in Brief for Defendant, p. 13. Where the licensee and patents are in the same hands there is some question as to whether royalties are an allowable expense on renegotiation. 32 C.F.R. § 1459.8(4) (Supp. 1952).

2. Two constituted a quorum of the board of five under the by-laws of the corporation. Letter from Henry M. Canby, Attorney for Defendant, to the *University of Pennsylvania Law Review,* Sept. 27, 1955, on file in Biddle Law Library, University of Pennsylvania Law School. The other directors were also named as defendants; however, service was only had on one, and the theory of recovery as to them was not clear. The defendant failed to brief the question so argument on it was postponed. Instant case at 922. At a later meeting, the board of directors, with defendant not voting, formally ratified the prior rejection by the Corporation of the offer of the patents. Brief for Defendant, p. 15.

3. Transcript, pp. 73-74, 80, cited in Brief for Defendant, p. 13 n.3.

member of the law firm which handled defendant's affairs. An accounting was ordered.[4] *Greene v. Allen,* 114 A.2d 916 (Del. Ch. 1955).

The traditional doctrine of corporate opportunity imposes liability upon a director for a purchase where the corporation has an "existing interest" in the thing purchased, or where the opportunity is "necessary for corporate existence or prosperity." [5] These labels are not susceptible of precise definition, but liability has been found, for example, where a director has purchased the renewal of a lease on property being used by the corporation,[6] a patent under which the complaining corporation had been operating,[7] or water rights which interfered with the enjoyment by the corporation of water rights in the same stream.[8] Where the opportunity is one which would be merely "advantageous" to the corporation, rather than one in which it has an "existing interest" or which is "necessary for corporate prosperity," the courts have found liability only in those cases where the purchase by the director is accompanied by some abuse of his position.[9] Abuse of position is usually predicated upon such evidence of disloyalty as the use of corporate funds,[10] credit,[11] name,[12] facilities or

4. The basis for the accounting is not clear. In this sort of situation, a director can be charged as a constructive trustee of the property and compelled to surrender it. 3 SCOTT, TRUSTS §§ 479, 499 (1939). However, defendant was not in possession of the patents. The patents may be reached in the hands of a transferee unless he is a bona fide purchaser. *Id.* § 470. The transferees in the instant case could not have been made parties to the action because it was not possible for the Delaware court to acquire jurisdiction over them. Letter from Milton Paulson, Attorney for Plaintiff, to the *University of Pennsylvania Law Review,* Dec. 14, 1955, on file in Biddle Law Library, University of Pennsylvania Law School. Since the complaint sought a decree "directing . . . defendant to cause the transfer to Airfleets of said patents . . . ," (*ibid.*) it apparently was the expectation of the plaintiff that defendant was in a position to reacquire the patents from the subsequent purchasers and have them turned over to the corporation.

5. See, *e.g.,* Carper v. Frost Oil Co., 72 Colo. 345, 211 Pac. 370 (1922); Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939); Blaustein v. Pan American Petroleum & Transport Co., 263 App. Div. 97, 31 N.Y.S.2d 934 (1st Dep't 1941), *aff'd,* 293 N.Y. 281, 56 N.E.2d 705 (1944).

6. Westerly Theater Operating Co. v. Pouzzner, 162 F.2d 821 (1st Cir. 1947); McCourt v. Singers-Bigger, 145 Fed. 103 (8th Cir. 1906); Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496, 28 So. 199 (1900).

7. Farwell v. Pyle-National Electric Headlight Co., 289 Ill. 157, 124 N.E. 449 (1919); Averill v. Barber, 53 Hun 636 (N.Y. Sup. Ct. 1889).

8. Nebraska Power Co. v. Koenig, 93 Neb. 68, 139 N.W. 839 (1913).

9. Lagarde v. Anniston Lime & Stone Co., 126 Ala. 496, 28 So. 199 (1900); Colorado & Utah Coal Co. v. Harris, 97 Colo. 309, 49 P.2d 429 (1935); Lancaster Loose Leaf Tobacco Co. v. Robinson, 199 Ky. 313, 250 S.W. 997 (1923); Greer v. Stannard, 85 Mont. 78, 277 Pac. 622 (1929); Bancroft v. Olympia Coal & Mining Co., 117 Wash. 211, 200 Pac. 1081 (1921); Tierney v. United Pocahontas Coal Co., 85 W. Va. 545, 102 S.E. 249 (1920). *But see* Production Machine Co. v. Howe, 327 Mass. 372, 99 N.E.2d 32 (1951).

10. Fleishhacker v. Blum, 109 F.2d 543 (9th Cir.), *cert. denied,* 311 U.S. 665 (1940); Balch v. Investors' Royalty Co., 7 F. Supp. 420 (N.D. Okla. 1934); Bardeleben v. Bessemer Land & Improvement Co., 140 Ala. 621, 37 So. 511 (1904); Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939).

11. Goodhue Farmers' Warehouse Co. v. Davis, 81 Minn. 210, 83 N.W. 531 (1900); Memphis & Arkansas City Packet Co. v. Agnew, 132 Tenn. 265, 177 S.W. 949 (1915).

12. Central Ry. Signal Co. v. Longden, 194 F.2d 310 (7th Cir. 1952); Chicago Flexotile Floor Co. v. Lane, 188 Minn. 422, 247 N.W. 517 (1933).

employees,[13] or knowledge gained through directorship [14] in developing opportunities for personal gain. Courts likewise have held that the purchase of an opportunity which the director specifically was authorized to acquire for the corporation will result in liability for the director.[15] But, in the absence of such indicia of abuse of position, the courts have uniformly held that directors may invest in opportunities which would have been merely advantageous for the corporation.[16]

Since the patents were not "necessary" for the existence or prosperity of the investment trust, and it did not have an "existing interest" in them, the instant case represents an extension of the doctrine of corporate opportunity in that it holds that a director, although he has not abused his position, is liable for taking for himself an opportunity which would have been merely "advantageous" for his corporation. While the previous cases have viewed corporate opportunity liability as a method of protecting the existing investments of stockholders, and preventing directors from using the corporation to serve their individual ends, the court here takes the quite different view that ". . . the rule of fiduciary conduct to be adopted should tend to encourage action in behalf of the corporation. . . ." [17] Several arguments support such an extension. First, the directors of a corporation are those on whom the responsibility devolves of discovering business opportunities which will enhance the earning power of the corporation. In an economy characterized by a marked divorce of ownership from management,[18] with concomitant stockholder apathy, there should be some means to stimulate a director to efforts on behalf of his corporation at the expense of his personal profit. If he is permitted to compete with his corporation as to those opportunities which the corporation could use to advantage the chances that a director will be unselfish are remote. Though it may be questionable whether the doctrine of the instant case will in fact result in greater efforts by directors for their corporations, at least it will remove the conflict of interest when an opportunity comes to a director which could be advantageous for his corporation.[19] Second, often investment opportunities will come to the director of an investment company because of a reputation gained through his stewardship of other people's money, and it seems unjust to let him profit at the expense of those whose money was necessary to the creation of the reputation which attracted the offer.

13. Central Ry. Signal Co. v. Longden, *supra* note 12; Goodhue Farmers' Warehouse Co. v. Davis, 81 Minn. 210, 83 N.W. 531 (1900).

14. Nebraska Power Co. v. Koenig, 93 Neb. 68, 139 N.W. 839 (1913); Young v. Columbia Oil Co., 110 W. Va. 364, 158 S.E. 678 (1931).

15. Tobin Grocery Co. v. Spry, 204 Cal. 247, 267 Pac. 694 (1928); Beaudette v. Graham, 267 Mass. 7, 165 N.E. 671 (1929); McKey v. Svenson, 232 Mich. 505, 205 N.W. 583 (1925).

16. See note 9 *supra*. See generally Notes, 39 COLUM. L. REV. 219 (1939), 54 HARV. L. REV. 1191 (1941).

17. Instant case at 919.

18. BERLE & MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

19. As the court pointed out, to hold otherwise would be to let the director pick and choose between himself and his corporation, keeping the most valuable investments for himself. Instant case at 919.

On the other hand the instant decision, in expanding the scope of directors' liability, may give rise to several problems. This further circumscription of directors' activities seems unnecessary because it is unlikely that a corporation will be hurt. In previous cases liability usually was restricted to the kind of purchase which deprived the corporation of an opportunity uniquely valuable for its business operations and the loss of which virtually always prejudiced the corporation.[20] If the opportunity is merely "advantageous," the corporation is injured, if at all, only to the extent that there were not available to it other equally advantageous offers. Secondly, the instant rule may result in both the corporation and its director losing the opportunity. Speed is often necessary in closing favorable transactions, especially in the investment field. But most boards of directors meet no more than once a month and a special meeting is frequently impracticable. It is true that a director could purchase such an opportunity and later offer it to the board. However, it is not likely that he will be willing to risk his capital in purchasing such an opportunity because he takes, in addition to normal investment risk, the gamble that if the opportunity appears profitable at the subsequent board meeting, with later and hence more complete information on its desirability, undoubtedly the corporation might accept it. Conversely, the chances that the board would accept what has developed to be a poor investment are remote. A third matter worth consideration is whether extension of liability may deter men of varied business interests, especially active financiers, from becoming directors, thereby depriving corporations of the expertise of such men. This deterrent effect is most clearly seen in an investment trust, which frequently, as here,[21] has no particular predisposition as to type of investment with the result that there are few opportunities which a director can take for himself with impunity, before rejection by an independent board. Finally, there is no guarantee that the men who do become directors will engage in greater efforts for their corporations rather than taking the safer and easier course of inaction. Because of these considerations it is questionable whether in practice the instant rule will operate to benefit the corporation and its stockholders.

Even where there is a finding that the asset purchased by the director is a corporate opportunity he will be absolved from liability if he can

20. See notes 6-8 *supra;* American Investment Co. v. Lichtenstein, 134 F. Supp. 857 (E.D. Mo. 1955); see also, *e.g.,* Guth v. Loft, Inc., 23 Del. Ch. 255, 5 A.2d 503 (Sup. Ct. 1939) (director of candy company held liable for purchase of syrup making patents and enterprise); News-Journal Corp. v. Gore, 147 Fla. 217, 2 So. 2d 741 (1941) (director held liable for purchase of vacant tract of land located at rear of the building occupied by his corporation and used for ingress and egress to the back entrance of the building); Production Machine Co. v. Howe, 327 Mass. 372, 99 N.E.2d 32 (1951) (director of corporation engaged in the manufacture of polishing machines held liable for taking contract for the manufacture of saw sharpening machines for his private corporation); Blake v. Buffalo Creek R.R., 56 N.Y. 485 (1874) (railroad directors held liable for purchasing rights of way along the projected route of the railroad).

21. Instant case at 921.

maintain the burden of proving good faith in the transaction.[22] Good faith may be predicated upon a showing that the corporation was unable to take the opportunity, as where it would be illegal for the corporation,[23] where the corporation is insolvent,[24] or where the third party refuses to deal with the corporation.[25] Good faith will be found also where the corporation was unwilling to make use of the opportunity, as where it is the settled policy of the corporation not to acquire the sort of property in question,[26] where the corporation has given up its negotiations,[27] or where the corporation through its board of directors has rejected the opportunity.[28] However, permission by the board of directors may be ineffective where it is given by those who share the profits of the usurpation,[29] where the defendant director's vote is necessary for a majority,[30] or where it is found that the defendant dominates the board.[31] There is rarely direct evidence of domination,[32] so the courts have inferred domination where the directors' decision is untenable. If gross misconduct is authorized, whereby the corporation sustains a positive injury, such as loss of its assets, the courts seem to reason that the directors could not have made an independent judgment.[33] In the instant case domination could not be inferred from the decision alone since the rejection was supported by some reasonable grounds[34] and no

22. See Solimine v. Hollander, 128 N.J. Eq. 228, 16 A.2d 203 (Ch. 1940); Turner v. American Metal Co., 268 App. Div. 239, 50 N.Y.S.2d 800 (1st Dep't 1944).

23. Jasper v. Appalachian Gas Co., 152 Ky. 68, 153 S.W. 50 (1913); Thilco Timber Co. v. Sawyer, 236 Mich. 401, 210 N.W. 204 (1926).

24. Presidio Mining Co. v. Overton, 261 Fed. 933 (9th Cir. 1919); Bentley v. Hetrick, 104 N.J. Eq. 535, 146 Atl. 320 (Ct. Err. & App. 1929).

25. Bisbee v. Midland Linseed Products Co., 19 F.2d 24 (8th Cir. 1927); see Keokuk Northern Line Packet Co. v. Davidson, 95 Mo. 467, 8 S.W. 545 (1888). *But see* N.Y. Automobile Co. v. Franklin, 49 Misc. 8, 17, 97 N.Y. Supp. 781, 787 (Sup. Ct. 1905).

26. Lancaster Loose Leaf Tobacco Co. v. Robinson, 199 Ky. 313, 250 S.W. 997 (1923); Bump Pump Co. v. Waukesha Foundry Co., 238 Wis. 643, 300 N.W. 500 (1941).

27. Pioneer Oil & Gas Co. v. Anderson, 168 Miss. 334, 151 So. 161 (1933).

28. Cowell v. McMillin, 177 Fed. 25 (9th Cir. 1910); Turner v. American Metal Co., 268 App. Div. 239, 50 N.Y.S.2d 800 (1st Dep't 1944); see Thilco Timber Co. v. Sawyer, 236 Mich. 401, 210 N.W. 204 (1926); McDermott Mining Co. v. McDermott, 27 Mont. 143, 69 Pac. 715 (1902).

29. Irving Trust Co. v. Deutsch, 73 F.2d 121 (2d Cir. 1934).

30. Long v. Wilson Stove & Mfg. Co., 277 Ill. App. 57 (1934).

31. Pepper v. Addicks, 153 Fed. 383 (E.D. Pa. 1907); Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892); *accord,* Hannerty v. Standard Theater Co., 109 Mo. 297, 19 S.W. 82 (1892); Fowle Memorial Hospital Co. v. Nicholson, 189 N.C. 44, 126 S.E. 94 (1925).

32. *But see* Pepper v. Addicks, *supra* note 31 (board authorized large unsecured loan to corporation controlled by defendant director, which was used exclusively for defendant's benefit, and changed by-laws so as to impede stockholders from getting information about the corporation's affairs; board members testified that they acted solely on defendant's advice).

33. Miner v. Belle Isle Ice Co., 93 Mich. 97, 53 N.W. 218 (1892) (director caused board to make contract leasing to corporation at exorbitant rentals property which he owned); *accord,* Hannerty v. Standard Theater Co., 109 Mo. 297, 19 S.W. 82 (1892) (board permitted forfeiture of a lease which was the entire corporate property; property was purchased by defendant director.); see Globe Woolen Co. v. Utica Gas & Electric Co., 224 N.Y. 483, 121 N.E. 378 (1918).

34. See note 1 *supra.*

such positive injury resulted as in those cases where domination was based primarily upon the untenability of the board's decision. The economic relationship of the defendant to the other directors coupled with the informality and location of the meeting at which the rejection took place are suggestive of domination. It is not altogether clear whether the court based its decision on these factors alone, and, if so, whether they should have been conclusive. If other factors played a part in the finding it is unfortunate that they were not articulated so as to provide a guide for future action by directors, especially in a situation where such broad liability is imposed.

Criminal Procedure—

INDICTMENT UPHELD EVEN THOUGH FOUNDED SOLELY ON HEARSAY EVIDENCE

Frank Costello pleaded not guilty to an indictment for federal income tax evasion. At the trial, it was disclosed that the only prosecution witnesses to appear before the grand jury had been three United States Treasury agents who had no personal acquaintance with Costello or his affairs. Costello's motion to dismiss the indictment on the grounds that there was no competent evidence before the grand jury on which an indictment could be predicated was denied. On appeal from his subsequent conviction Costello assigned as error, *inter alia,* the trial court's refusal to dismiss the indictment. The Second Circuit affirmed, holding that it is immaterial that only incompetent hearsay was adduced before the grand jury in support of the allegations of the indictment. *United States v. Costello,* 221 F. 2d 668 (2d Cir.), *cert. granted,* 76 Sup. Ct. 48 (1955).

At common law it was said that a grand jury should receive only legally competent evidence.[1] However, there is no agreement among the states as to the effect which the receipt of incompetent evidence by a grand jury should have upon the validity of an indictment. Some states refuse to entertain any inquiry into the competency or sufficiency of the evidence produced before the grand jury.[2] Others will quash indictments founded

1. *E.g.,* Charge to Grand Jury, 30 Fed. Cas. No. 18255, at 993 (C.C.D. Cal. 1872); United States v. Reed, 27 Fed. Cas. No. 16134, at 735 (C.C.N.D.N.Y. 1852). Lord Coke labeled as a "strange conceit" the theory that one may accuse by hearsay. 3 COKE, INST. 25 (1641). However, some English authorities held that, because of its ancient character as a secret accusatory tribunal, the grand jury might receive any evidence, regardless of its competency. *E.g.,* Regina v. Bullard, 12 Cox Cr. Cas. 353 (1872); Regina v. Russell, Car. & M. 247, 174 Eng. Rep. 492 (Ex. 1842); see 1 HOLDSWORTH, HISTORY OF ENGLISH LAW 147-48 (1903).

2. *E.g.,* State v. Chance, 29 N.M. 34, 221 Pac. 183 (1923), and cases cited therein; see ALI MODEL CODE OF CRIMINAL PROCEDURE, commentary § 138 (1930). *Cf.* State v. Shawley, 334 Mo. 352, 67 S.W.2d 74 (1933), indicating that Missouri will quash indictments only if the grand jury heard no evidence at all.

solely on incompetent evidence.[3] Though many states have enacted statutes limiting grand juries to the receipt of "legal evidence," [4] such statutes have generally been interpreted as directory rather than mandatory.[5] The prevailing rule in the federal courts has been that an indictment is not vitiated merely because some incompetent evidence was received by the grand jury,[6] but an indictment founded solely on such evidence may be quashed at the trial court's discretion.[7] However, the body of rules surrounding the exercise of this discretion provide so many opportunities for affirming a trial court's denial of a motion to dismiss an indictment that the circuit courts only rarely have reversed such a denial.[8] It is said that the trial court's discretion is not ordinarily subject to review,[9] that the defendant must prove affirmatively that the grand jury heard no competent evidence whatsoever,[10] and that the defendant may not be aided in this effort by granting an inspection of the grand jury minutes.[11] A few of the federal

3. *E.g.*, Dong Haw v. Superior Court, 81 Cal. App. 2d 153, 183 P.2d 724 (1947); People v. Derrico, 409 Ill. 453, 457, 100 N.E.2d 607, 610-11 (1951) (dictum); State v. Choate, 228 N.C. 491, 496, 46 S.E.2d 476, 479 (1948) (dictum). *Cf.* People v. Nitzberg, 289 N.Y. 523, 47 N.E.2d 37 (1943); People v. Nicosia, 164 Misc. 152, 298 N.Y. Supp. 591 (Kings Cty. Ct. 1937), indicating that in New York an indictment may be quashed for insufficient or incompetent evidence before the grand jury even though there may have been some competent evidence.

4. *E.g.*, ARK. STAT. ANN. §43-918 (1947); CAL. PEN. CODE §919 (1949); KY. CRIM. CODE PRAC. ANN. §107 (Carroll 1948); MINN. STAT. ANN. §628.59 (West 1947); MONT. REV. CODES ANN. §94-6318 (1947); NEV. COMP. LAWS §10822 (1929); N.M. STAT. ANN. §41-5-22 (1953); N.Y. CODE CRIM. PROC. §256; ORE. REV. STAT. §132.320 (1953).

5. *E.g.*, Murphy v. State, 171 Ark. 620, 286 S.W. 871 (1926); Commonwealth v. Minor, 89 Ky. 555, 13 S.W. 5 (1890); Territory v. Pendry, 9 Mont. 67 (1889). *Contra*, People v. Brickner, 8 N.Y. Crim. 217 (1891). Where statutes specify the reasons for which an indictment may be set aside, and the receipt of improper evidence is not among these reasons, most states hold it immaterial that such evidence was heard. *E.g.*, State v. Pfeiffer, 35 Ariz. 321, 278 Pac. 63 (1929); State v. DeGroate, 122 Iowa 661, 98 N.W. 495 (1904). *But see* People v. Glen, 173 N.Y. 395, 66 N.E. 112 (1903).

6. *E.g.*, Gates v. United States, 122 F.2d 571 (10th Cir. 1941), *cert. denied*, 314 U.S. 698 (1942); Murdick v. United States, 15 F.2d 965 (8th Cir. 1926); United States v. Frontier Asthma Co., 69 F. Supp. 994 (W.D.N.Y. 1947). *Contra*, United States v. Rubin, 218 Fed. 245 (D. Conn. 1914); United States v. Fitzpatrick, 16 Fed. 765 (W.D.N.C. 1883); United States v. Coolidge, 25 Fed. Cas. 622, No. 14858 (C.C.D. Mass. 1815).

7. *E.g.*, Nanfito v. United States, 20 F.2d 376 (8th Cir. 1926); United States v. Farrington, 5 Fed. 343 (N.D.N.Y. 1881); *cf.* Brady v. United States, 24 F.2d 405 (8th Cir. 1928).

8. Only two cases have been found reversing convictions because of the evidence received by the grand jury: Brady v. United States, 24 F.2d 405 (8th Cir. 1928); Nanfito v. United States, 20 F.2d 376 (8th Cir. 1926).

9. See, *e.g.*, Durland v. United States, 161 U.S. 306 (1896); Carrado v. United States, 210 F.2d 712 (D.C. Cir. 1953), *cert. denied*, 347 U.S. 1018, 1020 (1954), 349 U.S. 932 (1955); Lewis v. United States, 295 Fed. 441 (1st Cir. 1924). *But see* United States v. Rosenthal, 121 Fed. 862 (S.D.N.Y 1903).

10. *E.g.*, Cox v. Vaught, 52 F.2d 562 (10th Cir. 1931); Anderson v. United States, 273 Fed. 20 (8th Cir.), *cert. denied*, 257 U.S. 647 (1921); Chadwick v. United States, 141 Fed. 225 (6th Cir. 1905).

11. *E.g.*, United States v. Skurla, 126 F. Supp. 711 (W.D. Pa. 1954); United States v. Oley, 21 F. Supp. 281 (E.D.N.Y. 1937). *But see* United States v. Perlman, 247 Fed. 158 (S.D.N.Y. 1917); *cf.* United States v. Lydecker, 275 Fed. 976 (W.D.N.Y. 1921).

courts, like many of the states, permit no inquiry into the character of the evidence before the grand jury.[12] The Second Circuit has disclosed a marked antipathy toward efforts to dismiss indictments because of defects in the grand jury's evidence,[13] but until the *Costello* case it had employed the conventional theory that the defendant did not prove adequately the total absence of competent evidence before the grand jury as grounds for refusing to quash.[14] The *Costello* decision now abandons all pretense of requiring any competent evidence in support of indictments, and offers in its stead the standard of whether there was "some evidence" before the grand jury "that rationally established the facts." [15]

Although the grand jury was originally conceived to inquire after offenses and bring charges,[16] its investigative and accusatory functions have been largely supplanted by the development of the public prosecutor.[17] Thus, the primary remaining function of the grand jury is that of protecting the accused from unfounded prosecutions.[18] Two devices of the grand jury system are designed for the accused's protection: the grand jury's ultimate discretion to refuse to return a true bill,[19] and a minimum standard which the evidence before the grand jury must meet if the indictment is to withstand successfully a motion to dismiss.[20] The latter device, while

12. *E.g.*, McKinney v. United States, 199 Fed. 25 (8th Cir. 1912); United States v. Atlantic Commission Co., 45 F. Supp. 187 (E.D.N.C. 1942); United States v. Swift, 186 Fed. 1002 (N.D. Ill. 1911); United States v. Brown, 24 Fed. Cas. No. 14671, at 1274 (D.C. Ore. 1871).

13. See United States v. Beadon, 49 F.2d 164 (2d Cir.), *cert. denied*, 284 U.S. 625 (1931); United States v. Violon, 173 Fed. 501 (S.D.N.Y. 1909); *cf.* United States v. Herzig, 26 F.2d 487 (S.D.N.Y. 1928); United States v. Morse, 292 Fed. 273 (S.D.N.Y. 1922).

14. *E.g.*, Kastel v. United States, 23 F.2d 156 (2d Cir. 1927), *cert. denied*, 277 U.S. 604 (1928); United States v. Garsson, 291 Fed. 646 (S.D.N.Y. 1923); United States v. Gouled, 253 Fed. 242 (S.D.N.Y. 1918).

15. See instant case at 677. Whether such a broad reformulation of approach was necessary to the result is perhaps open to question in view of recent decisions supporting the competency of revenue agents' testimony in "net worth" tax prosecutions. *E.g.*, Banks v. United States, 204 F.2d 666 (8th Cir.), *cert. denied*, 346 U.S. 857 (1953), *order vacated*, 347 U.S. 1007 (1954), *cert. granted*, 348 U.S. 905 (1955); *cf.* United States v. Johnson, 319 U.S. 503 (1943). There is a possibility that legally admissible documentary evidence was received by the grand jury. Brief for Appellee, p. 44.

16. See POUND, CRIMINAL JUSTICE IN AMERICA 87, 109 (1945); Glaser, *The Political and Historical Development of the Grand Jury*, 8 LAW SOC. J. 192, 197-202 (1938).

17. See MOLEY, POLITICS AND CRIMINAL PROSECUTION 127-48 (1929); Miller, *Informations or Indictments in Felony Cases*, 8 MINN. L. REV. 379, 388 (1924); Morse, *A Survey of the Grand Jury System*, 10 ORE. L. REV. 101, 138 (1931).

18. See Hale v. Henkel, 201 U.S. 43, 59 (1906); Elliff, *Notes on the Abolition of the English Grand Jury*, 29 J. CRIM. L., C. & P.S. 3, 4-6 (1938); McClintock, *Indictment by a Grand Jury*, 26 MINN. L. REV. 153, 156-57 (1942); Glaser, *supra* note 16, at 202-04.

19. One of the most celebrated instances of the exercise of this discretion is the Earl of Shaftesbury's Case, 8 How. St. Tr. 759 (1681), in which the grand jury returned an "Ignoramus" on the Crown's bill accusing the Earl of treason. For an account of this and other famous 17th century incidents of grand jury resistance to Crown pressure, see Kinghorn, *The Growth of the Grand Jury System*, 6 L. MAG. & REV. 367, 371-81 (4th ser. 1880).

20. The cross-examination of witnesses by the grand jurors might be considered a third device. See People v. Sexton, 187 N.Y. 495, 514, 80 N.E. 396, 402 (1907).

ostensibly restraining the grand jury from the arbitrary return of indictments, has its direct effect upon the prosecutor, who generally controls the evidence presented before the grand jury.[21] To evaluate the apposition of such a standard of evidence to contemporary circumstances and the *Costello* rule as a particular expression of such a standard necessitates an examination of the milieu in which the standard must operate. It seems clear that the defendant under modern accusatory procedures need not rely solely, or even substantially, on the grand jury to protect him from the type of persecution which the grand jury system historically was intended to guard against. For one thing, the customary practice of a preliminary hearing before an examining magistrate[22] or, in the federal courts, a United States Commissioner,[23] insures that at least a prima facie case exists against the accused prior to any consideration of the case by the grand jury. Also, the political responsibility of the prosecutor and personal concern for a record of obtaining convictions are strong factors leading a prosecutor to refrain from seeking trial except where he believes he has a legally sufficient case.[24] In addition, the protection given the defendant by the assurance of a public trial hedged about with modern due process sanctions removes a large element of the rationale inherent in the early concept of the grand jury as a bulwark against tyranny.[25] At the same time, considerations of administrative efficiency make extended judicial review of the evidence received by the grand jury undesirable. Such considerations include the burden on the courts if they are required to re-do the work of the grand jury in addition to conducting trials,[26] the tactical advantages accruing to defendants from pre-trial divulgence of the prosecu-

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It has been contended that hearsay should be admitted before the grand jury because a grand jury investigation is not an adversary proceeding and, therefore, neither the accused nor his counsel is ordinarily present to cross-examine even first-hand witnesses; thus the most prominent justification for the rule excluding hearsay is not applicable. Instant case at 678. However, this particular argument seems to be offset by the cross-examination of first-hand witnesses that is conducted by the grand jurors themselves.

21. The accused has no right to appear before the grand jury. Duke v. United States, 90 F.2d 840 (4th Cir.), *cert. denied*, 302 U.S. 685 (1937); see FED. R. CRIM. P. 6(d). The prosecutor is the only one present who can distinguish competent from incompetent evidence. See United States v. Kilpatrick, 16 Fed. 765, 771-72 (W.D.N.C. 1883). In some states the accused is granted the right by statute to petition the grand jury for a hearing. *E.g.*, N.Y. CODE CRIM. PROC. § 257. Other jurisdictions provide that the grand jury may hear the accused if the court so directs. *E.g.*, State v. Hamlin, 47 Conn. 95, 104-05 (1879).

22. See ALI MODEL CODE OF CRIMINAL PROCEDURE §§ 39-60 (1930) and commentaries thereto.

23. FED. R. CRIM. P. 5(c). The rule also provides that the defendant ". . . may cross-examine witnesses against him and may introduce evidence in his own behalf."

24. For a discussion of the prosecutor's accusatorial discretion, see Note, *Prosecutor's Discretion*, 103 U. PA. L. REV. 1057, 1057-72 (1955).

25. This conception of the grand jury is strongly reflected in SOMERS, SECURITY OF ENGLISHMEN'S LIVES (1766), first published in 1681 as a justification of the grand jury's action in *Shaftesbury's* case.

26. See Note, *Quashing Federal Indictments Returned Upon Incompetent Evidence*, 62 HARV. L. REV. 111, 114-15 (1948); United States v. Fitzgerald, 29 F.2d 573, 576 (E.D. Pa. 1928); United States v. Swift, 186 Fed. 1002, 1018 (N.D. Ill. 1911).

tion's case,[27] and the delay in proceeding to trial that would arise from extensive pre-trial hearings on motions to dismiss indictments.[28] Furthermore, it seems undesirable to increase the workload of prosecutors, who are faced with the duty of presenting evidence to grand juries in thousands of cases each year,[29] by compelling them to select their witnesses before grand juries in accordance with stringent evidence requirements used in trials before petit juries. In view of these administrative benefits derived from a very limited judicial review of the grand jury's evidence and the problematical necessity of such review for safeguarding the accused, it is not surprising that the courts have generally been exceedingly reluctant to scrutinize the evidence produced before the grand jury for adherence to a standard of competency, probity or sufficiency.[30]

This judicial reluctance, combined with the customary rules against disclosure of grand jury proceedings,[31] has so impeded defense efforts to enforce the existing standard of "some competent evidence" that the standard has been practically negated. Few defendants are able to establish the incompetency of the evidence before the grand jury because the traditional secrecy surrounding grand jury proceedings prevents the gathering of proof. The defendant must have court permission to obtain testimony of the grand jurors as to the evidence received.[32] Although the federal rules impose no obligation of secrecy upon grand jury witnesses,[33] district courts often require such oaths,[34] in which case court permission likewise is required for disclosure by the witnesses.[35] Since most courts require a clear and positive showing that the grand jury heard no competent evidence as a prerequisite to interrogation of grand jurors[36] or witnesses,[37]

27. See Kastel v. United States, 23 F.2d 156, 158 (2d Cir. 1927), *cert. denied*, 277 U.S. 604 (1928), 38 YALE L.J. 680, 681 (1929); 1 CHITTY, CRIMINAL LAW § 317 (2d ed. 1826).

28. See United States v. Swift, 186 Fed. 1002, 1018 (N.D. Ill. 1911).

29. See DISTRICT ATTORNEY'S OFFICE OF PHILADELPHIA, ANNUAL REPORT 1952, at 12 (1953).

30. The federal courts, like the states, permit no inquiry at all into the sufficiency of the grand jury's evidence. United States v. Morse, 292 Fed. 273 (S.D.N.Y. 1922); United States v. Reed, 27 Fed. Cas. 727, No. 16134 (C.C.N.D.N.Y. 1852).

31. See United States v. Reed, 27 Fed. Cas., No. 16134, at 738 (C.C.N.D.N.Y. 1852). The historical secrecy of grand jury proceedings is intended to prevent the public circulation of accusations prior to the commencement of prosecution. United States v. Perlman, 247 Fed. 158, 160-61 (S.D.N.Y. 1917).

32. Schmidt v. United States, 115 F.2d 394 (6th Cir. 1940); United States v. American Medical Ass'n, 26 F. Supp. 429 (D.D.C. 1939); FED. R. CRIM. P. 6(e); *cf.* Atwell v. United States, 162 Fed. 97 (4th Cir. 1908) (secrecy not required after indictment found, accused apprehended, and grand jury discharged).

33. ADVISORY COMMITTEE ON RULES OF CRIMINAL PROCEDURE, NOTES TO THE RULES OF CRIMINAL PROCEDURE FOR THE DISTRICT COURTS OF THE UNITED STATES 7 (1945).

34. See Goodman v. United States, 108 F.2d 516 (9th Cir. 1939). The Supreme Court's Advisory Committee characterized the seal of secrecy on witnesses as "an unnecessary hardship" that "may lead to injustice." ADVISORY COMMITTEE ON RULES OF CRIMINAL PROCEDURE, *op. cit. supra* note 33, at 7.

35. United States v. Central Supply Ass'n, 34 F. Supp. 241 (N.D. Ohio 1940).

36. See, *e.g.*, United States v. American Medical Ass'n, 26 F. Supp. 429 (D.D.C. 1939).

37. See, *e.g.*, United States v. Central Supply Ass'n, 34 F. Supp. 241 (N.D. Ohio 1940).

defense counsel is often faced with the nearly impossible task of first proving the very fact which the testimony sought is needed to establish. The same obstacle exists where the defense seeks inspection of the grand jury minutes.[38] Finally, even if convincing testimony is presented, the defense must still overcome the unfavorable attitude of the courts toward efforts to quash indictments, as illustrated by the recondite reasoning to which the courts sometimes have resorted in rejecting defense proofs that the grand jury heard no competent evidence.[39] A realistic evaluation of the impact of the *Costello* rule can therefore be made only by reference to this practical context in which presumably it must operate. In this context there are so many judicially-created obstacles to the dismissal of indictments that the substitution of the *Costello* standard for the "some competent evidence" standard can have little concrete effect. If the courts have proved reluctant to enforce the standard of "some competent evidence" which, though illogical at times,[40] is at least ascertainable, then it is with something less than confidence that we may expect more rigorous enforcement of so elusive a standard as *Costello* offers.

If we could assume, on the other hand, that the standard of evidence would be effectively enforced, whether it be the existing standard or the *Costello* standard, a choice between the two acquires some significance. The existing requirement of a modicum of competent evidence affords the accused, as Judge Hand points out in the *Costello* opinion, "an utterly illusory protection." [41] Under that standard an indictment can be sustained if the grand jury heard the slightest competent evidence, however unpersuasive, since the federal courts consistently have refused to review the sufficiency of the grand jury's evidence.[42] The *Costello* standard, while dispensing with any requirement of technical evidentiary competency, does require that the grand jury hear at least some evidence which is probative. To that extent the accused under the *Costello* standard receives a more realistic guarantee of protection against baseless prosecutions. It is true, on the other hand, that the *Costello* standard removes any legal barrier to the return of indictments founded solely upon evidence which is inadmissible at trial.[43] Insofar as the accused may thereby be subjected to the

38. See note 11 *supra*.

39. *E.g.*, the highly technical reasoning used by the court in Radford v. United States, 129 Fed. 49, 52 (2d Cir. 1904).

40. For criticism of the rule excluding hearsay, see, *e.g.*, Robertson v. Hackensack Trust Co., 1 N.J. 304, 318, 63 A.2d 515, 522-23 (1949) (concurring opinion); McCORMICK, EVIDENCE 626-34 (1954); 1 MORGAN, BASIC PROBLEMS OF EVIDENCE 211-326 (1954); ALI MODEL CODE OF EVIDENCE, Introductory Note to rules 501-31, at 217-24 (1942).

41. Instant case at 678.

42. See note 30 *supra*.

43. There is no federal statute regulating proceedings before the grand jury or specifying the kind and degree of evidence necessary to the finding of a true bill. Although a copy of the indictment must be given the defendant prior to plea, FED. R. CRIM. P. 10, and persons charged with capital offenses must be given, in advance of trial, a list of the prosecution witnesses to be produced at trial and a list of the veniremen, 18 U.S.C. § 3432 (1952), there is no requirement, as in many state statutes, that the names of the grand jury's witnesses be endorsed upon the

hazard of trial without adequate justification, his protection is diminished by the *Costello* rule. Nevertheless, implicit in the *Costello* standard of evidence "that rationally established the facts" is the requirement that the evidence before the grand jury not be completely lacking in probity and reliability. This requirement, considered in view of the personal and political responsibility of the prosecutor, provides a better-balanced guarantee against persecution than does the technical focus of the "some competent evidence" rule.

That the rationale supporting the *Costello* standard is found in the availability of protection for the accused from sources independent of the grand jury, and in the need for administrative flexibility in our criminal procedures, highlights the questionable utility of the grand jury in modern circumstances. However negligible may be the impact of the *Costello* rule in practice, it undoubtedly will provide an opportunity for renewed discussion of the validity of the grand jury today.[44]

Criminal Procedure—

PERJURY NOT GROUNDS FOR REVERSAL IN ABSENCE OF DILIGENT EFFORT TO REBUT DURING TRIAL

Largely as a result of the testimony of Harvey Matusow, defendants were convicted of conspiring to violate the Smith Act.[1] Matusow subsequently proclaimed that the testimony which he had given at the trial was false.[2] On a motion for a new trial based on Matusow's recanting affidavit and other evidence of his false testimony, the court found that the witness had lied at the trial. However, without inquiring as to the possible effect of this testimony on the jury's verdict, the court denied a new trial to those defendants whose conversations with Matusow allegedly were held in the presence of a third person or persons. The basis for this ruling was that these defendants had not shown that properly diligent attempts had been made at the time of the trial to find the third parties to refute

bill. See, *e.g.*, ILL. ANN. STAT. c. 78, § 17 (Smith-Hurd 1935); OKLA. STAT. ANN. tit. 22, § 384 (1937); ORE. REV. STAT. § 132.580 (1953); VA. CODE ANN. § 19-132 (1950).

44. For criticisms of the grand jury as serving no useful purpose and as being a rubber stamp for prosecutors, see DISTRICT ATTORNEY'S OFFICE OF PHILADELPHIA, ANNUAL REPORT 1952, at 40 (1953); Morse, *A Survey of the Grand Jury System*, 10 ORE. L. REV. 295, 329 (1931); NATIONAL COMMISSION ON LAW OBSERVANCE AND ENFORCEMENT, REPORT ON PROSECUTION 124-25 (1931). *But see* White, *In Defense of the Grand Jury*, 25 PA. B.A.Q. 260 (1954); Dession, *From Indictment to Information—Implications of the Shift*, 42 YALE L.J. 163 (1932). The grand jury has been abolished in England as a useless relic. See Elliff, *supra* note 18.

1. 62 STAT. 808 (1948), 18 U.S.C. § 2385 (1952).

2. N.Y. Times, Feb. 1, 1955, p. 12, col. 5.

the perjured testimony.[3] *United States v. Flynn,* 130 F. Supp 412 (S.D.N.Y. 1955).[4]

It is well established that a new trial should not be granted automatically upon the presentation of recanting affidavits or allegations of falsity, but only with great caution.[5] The disposition of the motion is left to the discretion of the trial judge, and is reversed only for an abuse of that discretion.[6] The courts have established certain criteria by which the exercise of this discretion is to be tested. In *Martin v. United States,*[7] the Fifth Circuit held that a new trial should be granted whenever there has been a showing of falsity without which a conviction probably would not have been obtained. One year later, the Seventh Circuit, in *Larrison v. United States,*[8] added to the *Martin* doctrine an additional requirement: that the defendant must show that he was unable to meet the perjured testimony at the trial.[9] This rule, however, as applied in the *Larrison* case was, at best, an alternative holding since it was not necessary for that court's denial of the motion.[10] In *Gordon v. United States,*[11] the Sixth Circuit suggested that the requirement added in *Larrison* should not be applied, and in *United States v. Miller,*[12] a New York federal district court, without mentioning the *Larrison* rule, reverted to the Fifth Circuit

3. A new trial was granted to those defendants whose alleged conversations with Matusow had been held in private. The court reasoned that, since the only way these defendants could meet the perjured testimony was to take the stand, they were not able to meet the testimony unless they abandoned their privilege not to testify. The court was unwilling to abrogate that privilege, and ultimately concluded that as to these defendants, the jury might have acquitted without Matusow's testimony. Instant case at 421-22.

4. In Jencks v. United States, 6 CCH LAB. L. REP. (29 Lab. Cas.) ¶ 69523, at 90018 (5th Cir. Oct. 26, 1955), the court denied a new trial to defendant convicted of perjury for filing a false non-communist affidavit required by § 9(h) of the Taft-Hartley Act (61 STAT. 146 (1947), 29 U.S.C. § 159(h) (1952)) upon a finding that Matusow did not lie at the trial, and distinguished the instant case on the facts. The court cited Matusow for contempt. *Id.* at p. 90014.

5. United States v. Hiss, 107 F. Supp. 128 (S.D.N.Y. 1952), *aff'd,* 201 F.2d 372 (2d Cir.), *cert. denied,* 345 US. 942 (1953); United States v. Miller, 61 F. Supp. 919 (S.D.N.Y. 1945); see also United States v. Troche, 213 F.2d 401 (2d Cir. 1954); Harrison v. United States, 7 F.2d 259 (2d Cir. 1925); People v. Shilitano, 218 N.Y. 161, 112 N.E. 733 (1916); 37 MICH. L. REV. 1143 (1939); 39 MINN. L. REV. 316 (1955). Compare FED. R. CRIM. P. 33: "The court may grant a new trial to a defendant if required in the interest of justice. . . ." Note, however, that when a prosecuting official suborns false testimony, due process of law is violated. White v. Ragen, 324 U.S. 760 (1945); Mooney v. Holohan, 294 U.S. 103, 106 (1935) (dictum).

6. United States v. Johnson, 327 U.S. 106 (1946); United States v. Troche, 213 F.2d 401 (2d Cir. 1954); United States v. Johnson, 142 F.2d 588 (7th Cir.), *cert. dismissed,* 323 U.S. 806 (1944); Harrison v. United States, 7 F.2d 259 (2d Cir. 1925); Pettine v. Territory of New Mexico, 201 Fed. 489 (8th Cir. 1912).

7. 17 F.2d 973 (5th Cir.), *cert. denied,* 275 U.S. 527 (1927).

8. 24 F.2d 82 (7th Cir. 1929).

9. *Id.* at 88.

10. The court based its holding mainly on the fact that the witness had lied in his recantation which he had repudiated by a subsequent affidavit. 24 F.2d at 88. See also Johnson v. United States, 142 F.2d 588, 591 (7th Cir.), *cert. dismissed,* 323 U.S. 806 (1944).

11. 178 F.2d 896, 900 (6th Cir. 1949) (dictum).

12. 61 F. Supp. 919 (S.D.N.Y. 1945).

rule that a showing of perjury which may have affected the outcome of the case entitles the defendant to a new trial. Of those cases which have purported to follow the *Larrison* rule, virtually everyone has ruled that there has not been material perjury, thus obviating the necessity of considering the defendant's ability to meet the false testimony.[13] The instant decision is the first case in which a court has made the result turn on the issue of whether or not the defendant was able to meet the perjured testimony.[14]

The instant case indicates that the defendant must act at the time of the trial or waive his right to claim an improper conviction based on perjured testimony. This rule, at first, appears to be analogous to a waiver for failure to assert a privilege[15] or to object to evidence amenable to exclusionary rules.[16] The analogy, however, is not a good one. Since privileged testimony is usually of proper probative value, and hearsay evidence is at least possibly true, courts do not wish to eschew the evidence unless the party objects.[17] On the other hand, perjured testimony, by hypothesis, is false, and, therefore, there is no possibility that it could be evidence of proper probative value. A closer analogy to the rule of *Larrison* is the requirement of due diligence when newly discovered evidence is offered as a basis of a motion for a new trial.[18] Leading cases involving

13. See United States v. Troche, 213 F.2d 401 (2d Cir. 1954); Blodgett v. United States, 161 F.2d 47 (8th Cir. 1947). *But see* United States v. Johnson, 149 F.2d 31, 44 (7th Cir. 1945), *rev'd on other grounds*, 327 U.S. 106 (1946), where the court practically assumed that under the *Larrison* rule, defendant was unable to meet the evidence discovered subsequent to the trial, and, therefore, a new trial was granted.

14. Civil cases provide no definite guide on the "ability to meet" question on motions for a new trial based on perjured testimony. Most of these cases have been decided on the questions of whether or not there was perjury and whether the absence of the perjured testimony would have changed the result. See, *e.g.*, Taylor v. Ross, 150 Ohio St. 448, 83 N.E.2d 222, 10 A.L.R.2d 377 (1948). Two jurisdictions have taken a categorical stand in civil cases on the question presented by the *Larrison* rule. Maine has ruled that a new trial will not be granted where there is no showing of diligence. Boisvert v. Charest, 135 Me. 220, 193 Atl. 841 (1937). On the other hand, Kansas has ruled that a new trial will be granted despite a lack of diligence, at least where the opposing party has committed the perjury. Boxberger v. Texas Co., 156 Kan. 471, 134 P.2d 644 (1943); Scott v. Southwest Grease & Oil Co., 167 Kan. 171, 176, 205 P.2d 914, 919 (1949) (dictum). Pennsylvania courts have granted a new trial where a judgment has been obtained through perjured testimony without mentioning a diligence requirement. Blake v. Marinelli, 357 Pa. 314, 53 A.2d 550 (1947); Candelore v. Glauser, 291 Pa. 582, 140 Atl. 525 (1928); see also Hunter v. Thomas, 173 F.2d 810, 812 (10th Cir. 1949).

15. *E.g.*, the attorney-client privilege or the privilege against self-incrimination. See McCormick, Evidence §§ 91-100, 120-36 (1954).

16. *E.g.*, hearsay evidence. See McCormick, Evidence §§ 72 n.2, 223-29 (1954).

17. McCormick, Evidence § 72 (1954); 8 Wigmore, Evidence § 2291 (3d ed. 1940).

18. Although recanting affidavits and evidence of false testimony may properly be called "newly discovered evidence," People v. Shilitano, 218 N.Y. 161, 171, 112 N.E. 733, 736 (1916), the federal courts, for purposes of the disposition of the motion, distinguish the rules applicable to each. United States v. Marachowsky, 213 F.2d 235, 238 (7th Cir. 1954); United States v. Johnson, 142 F.2d 588, 592 (7th Cir.), *cert. dismissed*, 323 U.S. 806 (1944); United States v. Hiss, 107 F. Supp. 128, 136 (S.D.N.Y. 1952), *aff'd*, 201 F.2d 322 (2d Cir.), *cert. denied*, 345 U.S. 942 (1953).

the newly discovered evidence rule go so far as to hold that evidence which possibly could exonerate the defendant will not entitle him to a new trial unless the court is satisfied that there was a lack of knowledge of this evidence at the time of the trial and that the moving party was diligent in his attempts to discover it.[19] The effect of the holding in the instant case is the same as the result obtained under the newly discovered evidence rule, since, under this court's handling of the case, it is immaterial whether or not the jury would have convicted absent the perjured testimony. The policy which apparently motivates the pronouncement of such a severe rule in the newly discovered evidence cases is a desire to prevent delay, endless litigation, and expense caused by a defendant's negligent or intentional non-production of vital evidence. In addition, this doctrine gives the courts a more expeditious method of circumventing sham ancillary attacks.[20] Where newly discovered evidence is involved, the defendant may have the proof at his disposal; or if the evidence is not, in fact, obtainable, he has the ability to make the requisite efforts to produce it. The same is not true with perjury which the defendant first hears at trial. Hence he cannot be forearmed to meet the falsehood, whereas it is unusual that a defendant's initial opportunity to find newly discovered evidence arises during the trial. Even if defendant were able to present evidence refuting the perjury, his choice is only whether or not to attempt to combat a force which the opposition has set into motion. The positive act making possible an unjust decision is the responsibility of the prosecution. No similar fault on the part of the prosecution appears in cases involving newly found evidence. For another reason, the requirement of diligence is more easily rationalized in cases of newly discovered evidence than in cases involving perjured testimony; there is less likelihood of improper conviction in the former case than in the latter. In the newly discovered evidence cases, even though new evidence is offered which might, if accepted, lead to an acquittal, at least there has already been a showing in the record of sufficient valid evidence to prove defendant's guilt beyond a reasonable doubt. But under the rule of the instant case where perjured testimony is involved, the defendant may stand convicted on a record, which admittedly contains incompetent evidence that had an effect on the conviction as yet undetermined. Therefore, it would seem that the *Martin* rule is more in accord with our traditional sense of justice than the rule of the instant case, and nothing more should be required of the defendant before granting him a new trial than that he show that there was material perjury in the absence of which he might have been acquitted.

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19. Johnson v. United States, 32 F.2d 127 (8th Cir. 1929); United States v. Malfetti, 117 F. Supp. 468 (D.N.J.), *aff'd*, 213 F.2d 728 (3d Cir. 1954); see Brandon v. United States, 190 F.2d 175, 178 (9th Cir 1951); United States v. Fox, 95 F. Supp. 315, 319 (E.D. Pa. 1951).

20. See State v. Chadwell, 94 Kan. 302, 305, 146 Pac. 420, 421 (1915); Powell v. Commonwealth, 133 Va. 741, 752, 112 S.E. 657, 660 (1922).

Internal Revenue—

LOSS ON SALE OF BONDS DEDUCTIBLE AS BUSINESS EXPENSE RATHER THAN CAPITAL LOSS

Pursuant to the terms of a contract with a Finnish governmental agency, taxpayer was required to purchase and place U.S. Government bonds in escrow as security for its performance. Upon their release the bonds were immediately sold at a loss for which the taxpayer claimed a deduction as an "ordinary and necessary" business expense.[1] The Commissioner contended that the transaction resulted in a capital loss and disallowed the deduction.[2] The Tax Court, holding for the taxpayer, found that the bonds were acquired solely to comply with the provisions of the contract, and there was no intention to make an investment.[3] On appeal, the Second Circuit affirmed, holding that the transaction viewed as a whole was an "ordinary and necessary" incident in the company's regular business and, therefore, the loss was properly deductible as a business expense. *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944 (2d Cir. 1955), *cert. not auth.*, 5 CCH 1955 STAND. FED. TAX REP. ¶ 51104.

Since the initial enactment of the Internal Revenue Code, Congress always has permitted deductions from gross income and has taxed only net income.[4] The deductions allowed are those which normally are incurred in the production of income in a taxpayer's trade or business. Inasmuch as the loss in the instant case was sustained in consequence of fulfilling a requirement of a contract in the course of the taxpayer's business, it is in the nature of an allowable deduction. However, the current judicial interpretation of the code follows the doctrine that deductions are a matter of "legislative grace."[5] Thus it is a prerequisite to the allowance of a deduction for this loss[6] that Congress shall have made provision for it. Provision is made for the deduction of two classes of losses:[7] an ordinary

1. Int. Rev. Code of 1939, § 23(a)(1), 53 STAT. 12 (now INT. REV. CODE OF 1954, § 162(a)). There are no substantive changes in the new code. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A43 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 196 (1954).

2. Int. Rev. Code of 1939, § 23(g), 53 STAT. 13 (now INT. REV. CODE OF 1954, § 165(f); *id.* § 117(d)(1), as amended, 53 STAT. 869 (1939) (now INT. REV. CODE OF 1954, § 1211(a)). There are no substantive changes in the new code. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A46, A273 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 198, 431 (1954).

3. Bagley & Sewall Co., 20 T.C. 983 (1953), *nonacq.*, 1954-2 CUM. BULL. 6.

4. Griswold, *An Argument Against The Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace*, 56 HARV. L. REV. 1142, 1144 (1943).

5. New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934).

6. The court treated the problem as one dealing with the deduction of an ordinary and necessary business expense under § 23(a)(1). See note 1 *supra*. However, since the code treats losses and expenses differently it would seem improper to classify as an expense a deficit resulting from a disappearance of value attributable to a realization on a sale of an amount less than cost. Therefore, it is clear that the deficit realized in the instant case should be treated as a loss.

7. Int. Rev. Code of 1939, § 23, 53 STAT. 12-16 (now INT. REV. CODE OF 1954, §§ 161-75). There are no substantive changes in the new code affecting this case. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A43-A59 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 195-218 (1954).

loss sustained by the taxpayer during the taxable year is fully deductible,[8] whereas the deduction of a loss on the sale of a capital asset is limited, in the case of a corporation, to the extent of all capital gains realized in the year of the loss.[9] Therefore, it is explicit that a determination must first be made as to whether the property whose sale resulted in a loss is a capital asset, which is defined as all property held by the taxpayer with certain enumerated exceptions.[10] Since the bonds in the instant case do not fit within the language of any of the exceptions,[11] a literal interpretation of the statute requires that they receive the treatment prescribed for a capital asset. In prior cases involving property purchased as a necessary incident in the taxpayer's business, the courts, when they felt that the taxpayer should not be denied the benefit of a full deduction for a loss, have expanded the language of one of the capital asset exceptions [12] to exempt the property involved from that treatment.[13] In the instant case, rather than excessively broadening the meaning of the words which define a capital asset, the court adopted the novel, but improper, approach of treating the

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8. Int. Rev. Code of 1939, § 23(f), 53 STAT. 13 (now INT. REV. CODE OF 1954, § 165(a)).

9. See note 2 *supra.*

10. Int. Rev. Code of 1939, § 117(a)(1), as amended, 64 STAT. 932-33 (1950). (now INT. REV. CODE OF 1954, § 1221). A capital asset is "property held by the taxpayer (whether or not connected with his trade or business), but does not include—

"(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by a taxpayer primarily for sale to customers in the ordinary course of his trade or business;

"(B) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(1), or real property used in his trade or business."

Subsections C and D are inapplicable to the present problem. The only substantive change intended is the insertion of a new paragraph relating to certain accounts and notes receivable. H.R. REP. No. 1337, 83d Cong., 2d Sess. A273-74 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 431-32 (1954).

11. See note 10 *supra.*

12. The principal exception was that which excludes "property held . . . primarily for sale to customers in the ordinary course of his trade or business. . . ." Int. Rev. Code of 1939, § 117(a)(1), as amended, 64 STAT. 932-33 (1950) (now INT. REV. CODE OF 1954, § 1221). For a complete discussion of the problems created by this exception see Miller, *The "Capital Asset" Concept: A Critique of Capital Gains Taxation,* 59 YALE L.J. 837, 848-78 (1950).

13. For example, in Joe B. Fortson, 47 B.T.A. 158 (1942), *acq.,* 1942-2 CUM. BULL. 7, the board held that bonds received as compensation were held primarily for sale to customers in the ordinary course of business, and, therefore, the loss realized on their sale was fully deductible as an ordinary loss. However, since that provision was inserted to exclude from capital assets, property held as inventory, it is inapposite when applied to such bonds. See also the following cases where the courts have held that the properties involved were not capital assets. Hogg v. Allen, 105 F. Supp. 12 (M.D. Ga. 1952), *aff'd in part sub nom.* Edwards v. Hogg, 214 F.2d 640 (5th Cir. 1954); Western Wine & Liquor Co., 18 T.C. 1090 (1952) (shares of a distillery purchased to acquire liquor); Hercules Motors Corp., 40 B.T.A. 999 (1939), *nonacq.,* 1940-1 CUM. BULL. 7 (trade acceptances received for goods sold). *But cf.* those cases in which the courts have held that the properties involved were capital assets. Exposition Souvenir Corp. v. Commissioner, 163 F.2d 283 (2d Cir. 1947) (sale of debentures purchased to secure World's Fair concessions); Rockford Varnish Co., 9 T.C. 171 (1947) (notes received for goods sold).

loss as a business expense,[14] thereby obviating the necessity of considering the capital asset status of the bonds.[15]

Prior to the enactment of special tax treatment for capital assets, owners of property held for purposes other than resale were reluctant to sell since a large portion of any gain realized during the period the property was held would be lost through taxation at progressive rates.[16] As a result, investment capital, rather than having the mobility desired by Congress, had become frozen, thereby limiting the supply of capital necessary for economic progress and depriving the Treasury of any revenue from its accretion.[17] It also was believed that an equitable method to tax gains realized over a period of years would be in a manner that would approximate the tax which would have been paid if the gain had been realized ratably over the period the property was held.[18] Capital asset treatment was designed to promote these ends by limiting the effect of the progressive taxation of gains realized on the sale of certain assets.[19] Originally, a loss realized on the sale of these assets was deductible in full[20] on the theory that such treatment would lessen a disinclination to invest.[21] However, holders of securities then found it advantageous to sell their property after a price decline to realize a deductible loss and later reacquire similar investments after the "wash sales" period had elapsed.[22] Congress, after a

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14. See note 6 *supra.*

15. The instant case recently has been cited as authority in Tulane Hardwood Lumber Co., CCH TAX CT. REP. 21258 (Sept. 30, 1955), where the court permitted the deduction of a loss on debentures, purchased to insure a source of supply, as a business expense or a business loss under § 23. The tax court based its holding on the language of the instant case "'. . . that business expense, Section 23, has been many times determined by business necessity without a specific consideration of Section 117.'" *Id.* at 3071. By following the instant case, the court completely disregarded the provisions relating to that property in Int. Rev. Code of 1939, § 23(k)(2), 53 STAT. 13-14 (now INT. REV. CODE OF 1954, § 165(g)). There are no substantive changes in the new code relating to this case. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A46 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 198 (1954).

16. H.R. REP. No. 350, 67th Cong., 1st Sess. 10-11 (1921). For a detailed discussion of legislative history of capital assets, see Wells, *Legislative History of Treatment of Capital Gains Under the Federal Income Tax, 1913-48,* 2 NAT'L TAX J. 12 (1949).

17. See SEN. REP. No. 1567, 75th Cong., 3d Sess. 5-7 (1938); H.R. REP. No. 350, 67th Cong., 1st Sess. 10-11 (1921); H.R. REP. No. 1860, 75th Cong., 3d Sess. 7 (1938).

18. Wells, *supra* note 16, at 20; *Hearings Before the Subcommittee on Revision of Revenue Laws of the House Ways and Means Committee,* 73d Cong., 2d Sess. 38-39 (1934); SEN. REP. No. 558, 73d Cong., 2d Sess. 11-12 (1934). See note 17 *supra.*

19. See H.R. REP. No. 350, 67th Cong., 1st Sess. 10-11 (1921); SEN. REP. No. 558, 73d Cong., 2d Sess. 11-13 (1934); *Hearings Before the Subcommittee on Revision of Revenue Laws of the House Ways and Means Committee,* 75th Cong., 3d Sess. 38-43 (1938). See also H.R. REP. No. 1860, 75th Cong., 3d Sess. 33 (1938).

20. Revenue Act of 1921, § 206, 42 STAT. 232-33 (1921).

21. H.R. REP. No. 1860, 75th Cong., 3d Sess. 33 (1938).

22. H.R. REP. No. 1388, 67th Cong., 4th Sess. 2 (1923); see SEC'Y TREAS. ANN. REP. 14 (1922).

consideration of these factors, limited the deduction of losses on all capital assets in order to safeguard the revenue.[23]

However, it was found that the limitation on the deduction of capital losses was inhibiting the disposal of depreciable property used in a taxpayer's business, even though otherwise it was economically sound to replace such assets with more efficient ones.[24] To remedy this situation, Congress amended the definition of a capital asset to exclude entirely such depreciable property so that a loss thereon would be fully deductible.[25] But this exclusion meant that a gain on the sale of this property would be taxed progressively, a result contrary to the original reason for defining this property as a capital asset. In order to solve this dilemma, a hybrid classification was later enacted to provide that if there was a gain on the net result of transactions in depreciable property used in a taxpayer's business it will be taxed as a capital gain, while a loss will be taxed as an ordinary loss.[26]

The rationale behind the allowance of a full deduction for losses on the sale of depreciable property used in business is inapplicable to the bonds in the instant case. However, there are other legitimate reasons why the loss in the instant case should be deductible to a greater extent than the code specifies. Inasmuch as the fear of lost revenue resulting from a greater deduction of capital losses has been the *sine qua non* in determining that capital loss deductions must be limited,[27] and this fear stems principally from transactions in securities held for investment, it has little merit when treating securities held as a necessary incident in a taxpayer's business. It seems unlikely that securities so held will be susceptible to "tax sales" [28] in order to create losses. If the taxpayer does manipulate these securities in such a manner, the courts should have no difficulty in determining that the securities were no longer held as a necessary incident in the business. Furthermore, the amount of revenue lost by affording such securities greater loss deduction will be insignificant in terms of the national revenue picture. With this factor aside, the considerations of easing the burden of a capital loss in order to lessen a disinclination to purchase securities necessary to a business transaction and of giving the taxpayer, as a matter of fairness, the benefit of deducting a loss where a gain on the same trans-

23. Revenue Act of 1934, § 117(d), 48 STAT. 715, see SEN. REP. No. 558, 73d Cong., 2d Sess. 12 (1934); Wells, *supra* note 16, at 24.

24. *Hearings Before the Subcommittee on Revision of Revenue Laws of the House Committee on Ways and Means*, 75th Cong., 3d Sess. 42-43 (1938).

25. Int. Rev. Code of 1939, § 117(a), 53 STAT. 50 (now INT. REV. CODE OF 1954, § 1221).

26. To ease administrative difficulties, the same treatment was also provided for real property used in a taxpayer's business. Int. Rev. Code of 1939, § 117(a)(1),(j), added by 56 STAT. 846 (1942), as amended, 64 STAT. 932-33 (1950) (now INT. REV. CODE OF 1954, §§ 1221, 1231). There are no substantive changes in the new code affecting this case. See H.R. REP. No. 1337, 83d Cong., 2d Sess. A273, A275 (1954); SEN. REP. No. 1622, 83d Cong., 2d Sess. 431, 433 (1954).

27. See text at notes 21-23 *supra*.

28. See text at note 22 *supra*.

action would be taxed,[29] indicate that a loss on these securities should be fully deductible. However, until Congress acts to grant this relief, the courts should not take it upon themselves to grant relief other than as the code provides.[30]

If Congress acts to remedy this problem, an enlightened treatment for capital losses should provide separate deductions for each class of property defined as capital assets. Such factors as opportunities for "tax sales," need to encourage modernization of property, disinclination to invest, or potential revenue possibilities will vary in importance with each class of capital assets with the result that differing degrees of loss deduction will be called for. Since the rationale behind defining different types of property as capital assets was the uniform treatment to be accorded gains on such property,[31] a uniform provision for the deduction of capital losses is not necessarily required.[32]

29. Undoubtedly this factor has been considered by the courts which have not been slow to grant extra-statutory relief in cases involving this class of property. See cases cited in note 13 *supra.*

30. Instant case at 947, 950 (dissenting opinion).

31. See text at notes 16-19 *supra.*

32. Up to this time, when Congress wanted to allow a full deduction for a capital loss on certain property, it has eliminated the classification of that property as a capital asset in order to permit the loss to be deductible as an "ordinary loss" and has provided that the gain be taxed as "capital gain." See text at notes 24-26 *supra.* This has led to a criticism of such treatment as being inconsistent because it was reasoned that a gain or loss on the same property should be given exclusively "capital" or exclusively "ordinary" treatment. See H.R. REP. No. 2319, 81st Cong., 2d Sess. 45, 91 (1950). Apparently the criticism is directed at the labels, rather than the substantive treatment. Since there are valid policy arguments for the treatment given, regardless of the label, the provisons should be retained. However, there appears to be no reason why the same result cannot be accomplished by the simpler method of providing varying deductions for capital losses. Such treatment also may lessen the opposition of those who object on the grounds of inconsistency.